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ABSTRACT

This January 2000 audit report concerns the status of California community college districts' compliance with Section 84752 of the California Education Code, which prohibits districts from receiving full-time equivalent student (FTES) funding for activities that are fully funded through another source. The state apportions funds to districts based on students' class attendance. Districts use these funds to support their community colleges, including the instruction provided. Districts can use instructional service agreements (ISAs) to contract with public or private entities to provide specific training or services. According to Section 84752's regulations, community colleges can receive state apportionment funding for FTES in classes given through ISAs except when these classes are fully funded through another source. Most districts appear to be complying with these regulations. However, according to this report, the California Community Colleges Chancellor's Office is not properly monitoring ISAs and therefore cannot assure that all districts receiving funds through ISAs have met state requirements for receiving apportionment funding. Currently, the Chancellor's Office cannot identify districts with ISAs or the number of FTES those agreements generated to obtain state apportionment funding. If each district were required to report sufficient information about ISAs and the number of FTES claimed, it could better ensure that districts comply with state regulations. (KP)

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ED 461 398

California State Auditor

BUREAU OF STATE AUDITS

JC 020 131

California Community Colleges:

The Chancellor's Office Should Exercise Greater Oversight of the Use of Instructional Service Agreements for Training or Services

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January 2000
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CALIFORNIA STATE AUDITOR

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CHIEF DEPUTY STATE AUDITOR

January 28, 2000 96040

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Chapter 690, Statutes of 1997, the Bureau of State Audits presents its audit report concerning the status of community college districts' compliance with Section 84752 of the California Education Code that prohibits districts from receiving full-time equivalent student funding for activities that are fully funded through another source.

SUMMARY

The State apportions funds to California's community college districts (districts) based on students' attendance in the districts' classes. Districts use the apportionment funds they receive to support their community colleges, including the instruction provided. Districts can use instructional service agreements (ISAs) to contract with public or private entities to provide specific training or services. Furthermore, community colleges can receive apportionment funding for classes given through such agreements; however, state regulations prohibit the districts from requesting such funding for activities fully funded through another source. Although most districts appear to be complying with these regulations, the Chancellor's Office is not properly monitoring the ISAs. As a result, the Chancellor's Office cannot assure that all districts receiving funds through these agreements have met state requirements for receiving the funds.

In response to legislation enacted after the Bureau of State Audits (bureau) May 1996 audit, the Board of Governors of the California Community Colleges adopted revised regulations to prevent districts from inappropriately receiving

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state apportionment funds. However, the Chancellor's Office has been slow to review and follow up on annual audit reports of districts for which the certified public accountants (CPAs) report the districts' compliance with regulations concerning ISAs. For example, the Chancellor's Office had received 65 of the 71 audit reports for fiscal year 1997-98 by the end of January 1999; however, it had only reviewed 18 as of December 1999. We reviewed the audit reports for all 71 districts and found that the CPAs failed to report 8 districts' compliance with regulations for ISAs. In addition, 2 other audit reports indicated the districts had not complied with the regulations. Because the Chancellor's Office has not yet followed up on these issues, it cannot assure that the $1.3 million of apportionment funds these districts received through ISAs were justified.

Currently, the Chancellor's Office cannot identify districts with ISAs or specify the number of full-time equivalent students (FTES) those agreements generated to obtain state apportionment funding. If the Chancellor's Office required each district to report sufficient information about the agreements and the number of FTES claimed, it could more readily pinpoint specific high-risk districts when it follows up on annual audit reports and could better ensure that districts comply with state regulations.

BACKGROUND

The State apportions funds to California's community college districts based on students' attendance in the districts' classes. Districts use the apportionment funds they receive to support their community colleges, including the instruction provided. Districts use agreements to contract with public or private entities to provide specific training or services. Furthermore, community colleges can receive apportionment funding for classes given through such agreements; however, state regulations prohibit the districts from requesting such funding for activities fully funded through another source.

FTES is a workload measure representing 525 class hours of student instruction or activity in credit or noncredit courses. Generally, one FTES represents a student who attends community college courses three hours per day for one academic year. The Chancellor's Office uses the number of FTES reported by the districts to calculate each district's state apportionment funding.

Each district is eligible to receive up to a predetermined level of apportionment funding unique for that district. FTES in excess of this cap are not funded; however, if supplemental state funds later become available, the Chancellor's Office allocates the supplemental funds based on the district's unfunded FTES.

In May 1996, the bureau issued a report entitled *California Community Colleges: The State Paid Millions of Dollars to Community Colleges for Questionable Training Agreements.* That report addressed the use of ISAs by some districts to increase their claims for state apportionment funds. This increased claim for state funding was based on the additional number of FTES reported to the Chancellor's Office. We concluded that in some cases districts were not entitled to all the state apportionment funding they received because the FTES generated through ISAs between those districts and other state, local, and private entities did not meet minimum conditions required to qualify for state funds. We also concluded that some of the requirements in the regulations addressing the use of ISAs were too permissive, thereby costing the State millions of dollars for the districts' limited administrative support services for ISAs.

In September 1996, Section 84752 was added to the California Education Code specifying that districts could not receive FTES funding for activities fully funded through a source other than the district. In response to this legislation, the Board of Governors of the California Community Colleges amended Section 58051.5 of Title 5 of the California Code of Regulations (Title 5) to prohibit districts from claiming state apportionment funds when receiving full compensation for direct educational costs from another source. To clarify the requirements for using ISAs, the Chancellor's Office developed and provided a "Contract Guide for Instructional Service Agreements Between College Districts and Public Agencies" (contract guide) to each district. To ensure compliance, the Chancellor's Office also revised its "California Community Colleges Contracted District Audit Manual" (district audit manual) with additional specific instructions for the CPAs. This additional guidance assists the CPA in determining whether districts satisfy the requirements to qualify for apportionment funding using ISAs. This revised manual also provides the community colleges with further assistance in complying with the rules and regulations for claiming general apportionment funding using the FTES generated through training agreements with state and local entities.

Section 84752 also requires the state auditor to report to the Legislature on the status of district compliance with the section. In November 1997 because of the Chancellor's Office slow progress in completing its follow-up on the recommendations included in our May 1996 audit, the bureau issued a follow-up report on the districts' compliance with the amended district audit manual and contract guide. We also examined what the Chancellor's Office had done since our May 1996 report to implement our original recommendations.

In our initial follow-up, we concluded that the Chancellor's Office had only partially implemented the recommendations made in our May 1996 audit report. Specifically, the Chancellor's Office had only reviewed and reclaimed general apportionment funds from one of the three districts we identified as not satisfying the minimum conditions necessary to qualify the attendance of some students in contracted courses for state apportionment funding. Furthermore, we recommended that the Chancellor's Office continue to review CPA reports to identify districts that may have inappropriately received state apportionment funding. Finally, we stated that the Chancellor's Office should determine the correct amount of apportionment funding for those districts and recover any funds the districts were not entitled to receive.

SCOPE AND METHODOLOGY

Section 84752 of the California Education Code requires the bureau to report on the districts' compliance with the added regulations prohibiting them from receiving general apportionment funding for activities that are fully funded through another source. Because the district audit manual requires independent CPAs to assess whether districts fulfill the requirements for receiving FTES funding for classes provided through ISAs, we reviewed the annual CPA reports for the 71 districts.

In addition, we reviewed the listing of audit findings from prior years from those same reports to identify any chronic situations of improper practices using ISAs. Furthermore, we asked the Chancellor's Office what actions it had taken to resolve the issues we noted in our review of the districts' annual audit reports. Specifically, we discussed these deviations with the Chancellor's Office specialist for Fiscal Services and its specialist

in the Economic Development/Vocational Education Division, who are responsible for following up on concerns CPAs raise regarding ISAs used by the various districts.

THE CHANCELLOR'S OFFICE IS NOT PROPERLY MONITORING COMMUNITY COLLEGE DISTRICTS' USE OF ISAs

The Chancellor's Office has been slow to monitor and follow up on district annual audits performed by local independent CPA firms. Despite having most of fiscal year 1997-98 audit reports since the end of January 1999, the Chancellor's Office had not completed its review of these reports as of December 8, 1999. Specifically, although it received 65 of the 71 audit reports by January 31, 1999, the Chancellor's Office had only reviewed 18 as of December 8, 1999. We reviewed the audit reports for all 71 districts and found no instances of districts claiming FTES for classes fully funded through other sources. In 61 of the 71 districts, the CPAs determined that the districts used ISAs in accordance with Title 5 regulations or that the districts did not have such agreements. We did note, however, that CPAs failed to report whether 8 districts complied with regulations for ISAs. In addition, we noted that audit reports for 2 other districts indicated they had not complied with the regulations.

Because it had not reviewed any of these 10 audit reports, the Chancellor's Office was not aware that some CPAs had not reported on certain districts' compliance or that 2 districts had actually failed to comply with the regulations. Furthermore, we determined that 4 of the 10 districts received about $1.3 million in apportionment funding through ISAs. Moreover, since it has not yet reviewed all 71 audit reports, the Chancellor's Office has only limited assurance that it properly allocated funding to these and other districts. Finally, the Chancellor's Office has not incorporated audit procedures into its district audit manual to require auditors to specifically test district compliance with regulations addressing classes fully compensated through another source.

Two Districts Did Not Meet Requirements to Receive Apportionment Funding for ISAs

The fiscal year 1997-98 audit reports for Barstow and Lassen community college districts reported that they had ISAs with other entities. Because some of the instructors under those

agreements did not have signed contracts with their districts, any additional FTES these two districts claimed for courses the instructors taught would not comply with existing Chancellor's Office regulations and therefore would not qualify for apportionment funding. When we contacted Lassen and Barstow, they told us they included FTES generated through these ISAs in the total number of FTES they claimed for state apportionment funds. Therefore, these districts have inappropriately received state funding. Sections 58051 and 58058 of the California Code of Regulations require that such contracts with instructors must be signed to properly claim FTES and be eligible to receive state apportionment funding. Furthermore, the audit report for Barstow Community College District indicated that this issue of having unsigned instructor contracts occurred in both fiscal years 1996-97 and 1997-98.

To assess the significance of this issue, we determined that Barstow Community College District claimed approximately 72 FTES from one contract while Lassen Community College District claimed approximately 80 FTES from five contracts. Based on our estimated values of these FTES as shown in Table 1, these districts received approximately $422,000 for agreements that did not fully meet the minimum requirements of state regulations. The Chancellor's Office should follow up with both these districts and determine the number of FTES used to generate additional apportionment funding from inadequate instructor contracts.

To calculate the estimated value of the FTES associated with the contracts, we determined the average amount of state apportionment funds per FTES that each district received during fiscal year 1997-98. We then multiplied this average by the number of FTES associated with the district's ISAs in question. For example, Lassen Community College District reported 2,536 FTES and received a total of $7.96 million of state funds for an average of $3,140 per FTES. Using this average, we determined that for the 80 FTES it reported for ISAs, it received more than $251,000 in state funding.

In November 1999 when we asked the Chancellor's Office to describe any follow-up action it took with Lassen and Barstow community college districts, the Chancellor's Office indicated that it had not reviewed these districts' audit reports and therefore had not yet taken any action. The Chancellor's Office

TABLE 1

Fiscal Year 1997-98 Estimated Average FTES Value—State Funds Only

Community College District	Total Funded FTES (all types)	Number of ISAs	Reported FTES From ISAs	Estimated Average State Funds per FTES	Number of FTES Claimed	Estimated Fiscal Year 1997-98 Apportionment in Question
Barstow	1,743	1	72	$2,366	72	$170,352
Lassen	2,536	5	80	3,140	80	251,200
Total	**4,279**	**6**	**152**		**152**	**$421,552**

further explained that because of staffing shortages it had not promptly completed its review, but had hired an additional staff person as of October 25, 1999, and would soon eliminate its backlog of unfinished work.

Two Audit Reports Did Not Provide the Required Assurance That Districts Claimed FTES In Accordance With State Regulations

In addition to the lack of compliance by these two districts, we noted that for eight other districts the CPAs had failed to indicate whether they had reviewed ISAs for those districts. After we brought it to their attention, the CPAs for three of the districts subsequently revised their audit reports to indicate that those districts had complied with the state regulations concerning ISAs. We contacted the remaining five districts and determined that three did not have ISAs, while El Camino did have agreements that generated approximately 396 FTES. Meanwhile, the remaining district, Chabot-Las Positas, generated 98 FTES by providing instructional services at a county sheriff's training facility even though it did not have an ISA with that entity for fiscal year 1997-98. Based on our estimates of the FTES values for these two districts as shown in Table 2, they received a total of approximately $862,000 for the FTES generated through their ISAs. Because the Chancellor's Office has no assurance that any of these agreements or FTES were examined in the districts' annual audits, it cannot be sure that these districts were entitled to receive any or all of the $862,000.

The district audit manual requires CPAs to examine ISAs and the resulting apportionment funding as part of the district's annual audit. When we followed up with the Chancellor's Office regarding these eight audit reports, it indicated that it had not

yet reviewed any of them and was unaware that the reports omitted the mandatory examination of ISA compliance. The Chancellor's Office also indicated it would follow up by November 30, 1999, with the respective CPA firms or the eight districts to resolve the compliance issues we noted. As of the end of December 1999, the Chancellor's Office had not yet fully resolved these issues.

TABLE 2

Fiscal Year 1997-98 Estimated Average FTES Value—State Funds Only

Community College District	Total Funded FTES	Number of ISAs	Reported FTES From ISAs	Estimated Average State Funds per FTES	Number of FTES Claimed	Estimated Fiscal Year 1997-98 Apportionment In Question
Chabot-Las Positas	13,270	0	98	$1,554	98	$152,292*
El Camino	16,990	2	396	1,791	396	709,236
Total	**30,260**	**2**	**494**		**494**	**$861,528**

* Although Chabot-Las Positas Community College District claimed 98 FTES for services provided at the sheriff's academy during fiscal year 1997-98, the district did not have an ISA for that year. It did have such an agreement for fiscal year 1998-99.

The Chancellor's Office Lacks Information to Determine Which Districts Have ISAs

Although the Chancellor's Office has developed regulations to ensure districts do not violate Section 84752 of the Education Code prohibiting receipt of FTES funding for activities that are fully funded through another source, it cannot independently evaluate the effectiveness of those regulations. Currently, the only source of information the Chancellor's Office has for ISAs and any resulting FTES claimed is the annual audit report submitted by each district.

When we asked if the Chancellor's Office could provide us with the number of FTES individual districts generate from ISAs, we were told such information is not available at the Chancellor's Office. Without knowing which districts generate FTES through ISAs, the Chancellor's Office cannot assess which districts may be more likely to receive state apportionment funding based on agreements that do not comply with the requirements outlined in the district audit manual or the contract guide.

Furthermore, although the Chancellor's Office revised its district audit manual to require the CPAs to test agreements, its suggested audit procedures do not include such items as verifying that contracting entities certify that the direct education costs of their classes are not being fully funded through other sources. Such a certification is required by Section 58051.5 of Title 5. Because it did not include this provision in its district audit manual, the Chancellor's Office has less assurance that districts comply with its provisions.

The misuse of ISAs to generate state apportionment funding, which prompted our first audit of this issue in 1996, was revealed by an independent examination of a district's ISAs and related FTES practices. More than three years later, the Chancellor's Office still does not have a satisfactory mechanism to identify districts that use such agreements. Information identifying those districts with ISAs and the number of FTES credits claimed would assist the Chancellor's Office in minimizing its risk of distributing state apportionment funds to districts that do not qualify for such funds.

The Chancellor's Office should have the capability to select and independently review ISAs from districts that generate significant levels of FTES through such agreements. For example, if the Chancellor's Office had requested that all districts report their ISAs, it could have used such a list to determine which audit reports should have included an evaluation of the districts' compliance with state regulations regarding those agreements. In addition, the Chancellor's Office could use the annual audit reports and its list of districts with ISAs to identify districts with a higher risk of noncompliance. For example, using data gathered from our 1996 audit, we determined that five of the eight districts for which the CPAs failed to report on ISA compliance for fiscal year 1997-98 also had ISAs and claimed FTES credit in either fiscal years 1994-95, 1995-96, or both. In addition, the two districts for which the CPAs identified issues in fiscal year 1997-98 also claimed FTES credit for ISAs in both fiscal years 1994-95 and 1995-96. Therefore, if the Chancellor's Office had a list identifying districts that use ISAs to generate FTES, it could prioritize its reviews of audit reports to assure that the reports for those districts are reviewed first.

RECOMMENDATIONS

To ensure that it can effectively administer the allocation of state apportionment funding of community college districts, making sure that districts do not receive state apportionment funding generated through FTES for activities that are fully funded through another source, the Chancellor's Office should:

- Review district audit reports to ensure that CPAs have performed the required audit procedures to assess district compliance with state regulations on ISAs and promptly follow up on any state compliance issues identified in these annual audits.

- Determine whether the FTES credits Barstow and Lassen community college districts generated through their respective ISAs complied with the State Education Code and the Board of Governors' regulations. The Chancellor's Office should also determine whether the FTES credits generated by Chabot-Las Positas Community College District in its arrangement with the sheriff's academy met the requirements for state apportionment.

- Require districts to submit to the Chancellor's Office a list of their ISAs and the number of FTES the districts estimate they will generate through such agreements. The Chancellor's Office should utilize this information in its review and follow-up of the districts' annual audit reports to better assure that districts are entitled to the apportionment funding.

- Revise Section 423 of its Contracted District Audit Manual to require CPAs to specifically test the districts' compliance with regulations that prohibit them from claiming FTES for classes fully funded through another source.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Mary P Noble

MARY P. NOBLE
Acting State Auditor

Date: January 28, 2000

Staff: Elaine Howle, CPA, Deputy State Auditor
Arthur Monroe, CPA
Brian Kishiyama

Agency response provided as text only.

California Community Colleges
Chancellor's Office
1102 Q Street
Sacramento, CA 95814-6511

January 25, 2000

Mary Noble
Acting State Auditor
555 Capitol Mall, Suite 300
Sacramento, California 95814

Dear Ms. Noble:

Thank you for the opportunity to comment on issues raised by the Bureau's draft audit report entitled California Community Colleges: The Chancellor's Office Should Exercise Greater Oversight of the Use of Instructional Service Agreements.

General Comment

We hired a new staff member on October 15,1999 and that staff has been working on the audit workload. We have currently reviewed 42 of the 59 audit reports received for fiscal year 1998-99 while following up with districts that have not yet submitted their audit reports. We are currently working with the four districts identified in the audit report to resolve all issues regarding Instructional Service Agreements.

The following are our responses to the recommendations included in the audit report:

- Review district audit reports to ensure that CPAs have performed the required audit procedures to assess district compliance with state regulations on instruc tional service agreements and promptly follow up on any state compliance issues identified in those annual audits.

As stated above, we are current on the fiscal year 1998-99 audit reviews.

- Determine whether the FTES credits Barstow and Lassen Community College Districts generated through their respective instructional service agreements complied with the State Education Code and the Board of Governors' regula tions. The Chancellor's Office should also determine whether the FTES credits generated by Las Positas Community College in its arrangement with the sher iffs academy met the requirements for state apportionment.

  This will be done.

- Require community college districts to submit to the Chancellor's Office a list of their instructional service agreements and the number of FTES the districts estimate they will generate through such agreements. The Chancellor's Office should utilize this information in its review and follow-up of the districts' annual audit reports to better assure that districts are entitled to the apportionment funding.

  The Chancellor's Office will explore the possibility of gathering information regarding FTES generated at each community college by instructional service agreements through the automated reporting system currently in place.

- Revise Section 423 of its Contracted District Audit Manual to require district auditors to specifically test the districts' compliance with regulations that prohibit them from claiming FTES for classes fully funded through another source.

  This will be done.

Thank you again for the opportunity to respond to this audit report. Please contact Gary Cook at *(916)* 327-6222, if you have any questions.

Sincerely,

(Signed by: Thomas J. Nussbaum)

Thomas J. Nussbaum
Chancellor

Agency response provided as text only.

Barstow College
2700 Barstow Road
Barstow, California 92311

January 24, 2000

Mary P. Noble, Acting State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Noble:

Barstow College has received one portion of Report No. 96040 entitled "California community Colleges: The Chancellor's Office Should Exercise Greater Oversight of the Use of Instructional Training Agreements" from the Bureau of State Audits. On behalf of Barstow College, I request the following comments be included in the report.

> Barstow College has contracted with the Barstow Academy of Beauty for almost ten years to provide a cosmetology program. The College has always had primary supervision of the program, including establishing the curriculum and objectives. Each instructor has met the qualifications required for community college cosmetology programs.
>
> In response to a finding from the Barstow College annual audit report, the College completed a new agreement with the Academy of Beauty in 1998. Besides outlining the general requirements of the program, the agreement also describes the terms and working conditions of the instructor, including compensation.
>
> The purpose of the new agreement was to ensure the requirements established by the state were met. However, the College does not have a signed contract specifically with the instructor. Barstow College will immediately correct this omission.

Thank you for the opportunity to respond to the Bureau of State Audits report.

With high regards, I am

(Signed by: Dr. James Meznek)

Dr. James Meznek
President/Superintendent

Agency response provided as text only.

El Camino Community College District
16007 Crenshaw Boulevard
Torrance, California 90506-0001

January 25, 2000

Elaine Howle
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

El Camino Community College District was mentioned in the DRAFT of the California State Auditor's report on the use of instructional training agreements during 1997-98. It was noted that the college did have instructional service agreements in place and that they generated approximately 396 FTES for 1997-98. In the 1997-98 district audit, the audit firm used for that year, KPMG Peat Marwick. did not indicate whether they had reviewed the instructional service agreements.

We have been in contact with representatives of that firm to indicate to them that agreements were indeed in place and asked if they would revise their audit reports to indicate that the District had complied with the state regulations concerning ISAs.

Representatives of KPMG Peat Marwick advised me they spoke with Steve Nakamura in the Chancellor's Office and he indicated since the ISA was reviewed in the audit of 1998-99 performed by Vicenti Lloyd Stutzman, there might not be a need to go back and review the 1997-98 audit. As of this date they are still awaiting a final confirmation of that communication.

Page 59 of the Vicenti Lloyd Stutzman "Report on Audit of Financial Statements and Supplementary Information Including Reports of Compliance", dated June 30, 1999, states El Camino Community College District complied with the compliance requirements for "whether the District has the appropriate documentation to support the FTES, if any, that are claimed for instructional service agreements/contracts."

Should you have any questions regarding the ISAs, I can be reached at (310) 660-3109.

Sincerely,

(Signed by: Pamela Fees)

Pamela Fees
Business Manager

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
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